*Miller v. Flume**

I. INTRODUCTION

Issues of arbitrability frequently arise between parties to arbitration agreements. Typically, parties opposing arbitration on the ground that there is no agreement to arbitrate will seek an initial ruling from the courts on whether the parties must proceed to arbitration.[1] Nonetheless, questions often surface with respect to who should decide the arbitrability of a particular dispute—the court or the relevant arbitrator? Recent attempts by the Supreme Court to resolve the inconsistencies among lower courts have failed to end all confusion over who decides arbitrability under a particular agreement.[2]

Miller involved a dispute between investors and their brokerage firm, which allegedly mishandled funds, as well as particular brokers, who allegedly fraudulently transferred funds away from their firm to avoid paying an arbitral award that the investors won against the firm.[3] The brokers brought suit to enjoin a second arbitration initiated by the investors to hold particular brokers liable for the award.[4] In *Miller*, the Seventh Circuit, applying Supreme Court case law, held that where parties had consented to National Association of Securities Dealers (NASD) arbitration rules, the issue of arbitrability of the dispute is left to the courts absent a "clear and unmistakable" intent by the parties to have the arbitrator determine this threshold question.[5]

II. FACTS AND PROCEDURAL HISTORY

In late 1986 or early 1987, Dr. Charles W. Flume, a dentist in Wisconsin, "sought investment advice for his retirement savings from the now defunct firm of Heiner & Stock."[6] The parties established the Charles

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* 139 F.3d 1130 (7th Cir. 1998).

[1] *See* Carroll E. Neesemann & Maren E. Nelson, *The Law of Securities Arbitration, in* SECURITIES ARBITRATION 1998: REDEFINING PRACTICES AND TECHNIQUES 319, 420 (PLI Corporate Law & Practice Course Handbook Series No. 1062, 1998).

[2] *See id.*

[3] *See Miller*, 139 F.3d at 1131.

[4] *See id.*

[5] *See id.* at 1133-1134.

[6] Hayne, Miller & Farni, Inc. v. Flume, 888 F. Supp. 949, 951 (E.D. Wis. 1995).

W. Flume, D.D.S., S.C., Defined Benefit Plan[7] under the Employee Retirement Income Security Act[8] (ERISA). Dr. Flume and his wife were the sole beneficiaries.[9]

In February 1988, James D. Peterson, then a broker at Heiner & Stock, began managing the plan.[10] In May 1990, Mr. Peterson transferred the plan and his license to sell securities to HMF, a New York corporation and a member of the NASD.[11]

"In June 1993, the Flumes commenced an NASD arbitration asserting various claims against HMF, including common law claims of fraud, breach of fiduciary duty, negligence, ERISA violations, and state and federal securities fraud."[12] In their complaint, the Flumes alleged that the plan incurred losses of $300,000 due to mishandling by the brokers.[13] "HMF responded and filed a counterclaim. Both HMF and the Flumes signed Uniform Submission Agreements consenting to arbitration of the dispute in accordance with Section 12 of the NASD Code of Arbitration Procedure. . . . On March 15, 1994, the arbitrators awarded the Flumes $150,000 in damages and $28,034.40 in costs."[14] HMF filed a motion to vacate the award, which the magistrate and district court denied.[15]

While the motion to vacate was pending in the district court, the Flumes discovered that HMF had ceased operations.[16] HMF failed to pay any part of the judgment in favor of the Flumes and "filed for withdrawal of its broker/dealer license with the NASD."[17]

The Flumes subsequently learned that the brokers, including Kevin Miller, had transferred assets away from HMF.[18] The brokers allegedly transferred a portion of these assets to a new brokerage firm that Miller

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[7] *See id.*

[8] Employee Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 26 U.S.C., 29 U.S.C. §§ 1001–1461).

[9] *See Flume*, 888 F. Supp. at 951.

[10] *See id.*

[11] *See id.*

[12] *Id.*

[13] *See id.*

[14] *Id.*

[15] *See id.* at 954–955.

[16] *See* Miller v. Flume, 139 F.3d 1130, 1132 (7th Cir. 1998).

[17] *Id.*

[18] *See id.*

controlled.[19] The Flumes, claiming that Miller and other principals had fraudulently transferred funds in order to avoid paying the award, initiated a second NASD arbitration in 1995.[20]

The brokers subsequently filed a complaint in district court seeking a declaration that they were not required to arbitrate with the Flumes.[21] The district court granted the brokers' motion for a preliminary injunction against the Flumes' arbitration.[22] The district court held that section 35 of the NASD Code of Arbitration Procedure, on which the Flumes relied, is not the kind of "clear and unmistakable expression of the parties' intent to have the arbitrator, not the court, determine the question of arbitrability."[23] The district court further held that the Flumes' complaint fell outside the scope of the NASD agreement and that the claim was not arbitrable.[24]

On appeal, the Seventh Circuit affirmed the district court's holding that the question of arbitrability of the dispute was for the courts to decide, not the arbitrator.[25] However, the court held that, under the terms of the NASD agreement, the brokers were required to submit to arbitration proceedings.[26]

III. THE SEVENTH CIRCUIT'S DISCUSSION OF ARBITRABILITY

In its discussion of the Flumes' claim, the court analyzed the Supreme Court's holding in *First Options of Chicago, Inc. v. Kaplan*.[27] Citing *Kaplan*, the court stated that it would not "assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so."[28] Thus, the court analyzed the documents that constituted "the

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[19] *See id.*

[20] *See id.* The Flumes alleged that the brokers' actions violated various rules of the NASD, and for that reason they claimed the right to bring this second arbitration under the NASD's rules. *See id.*

[21] *See id.* at 1133.

[22] *See id.* (citing Miller v. Flume, No. 96-C0029, memorandum and order at 11 (E.D. Wis. Dec. 26, 1996)).

[23] *Id.* (citing Miller v. Flume, No. 96-C0029, memorandum and order at 6 (E.D. Wis. Dec. 26, 1996)).

[24] *See id.* (citing Miller v. Flume, No. 96-C0029, memorandum and order at 8 (E.D. Wis. Dec. 26, 1996)).

[25] *See id.* at 1134.

[26] *See id.* at 1137.

[27] 514 U.S. 938 (1995).

[28] *Miller*, 139 F.3d at 1133 (citing *Kaplan*, 514 U.S. at 944).

arbitration agreement between the Flumes and the brokers to determine if clear and unmistakable evidence was present."[29]

The Flumes argued that this unmistakable evidence was present in three sections of the NASD Manual's Code of Arbitration Procedures.[30] The Flumes argued that, based on the language of these sections, the parties clearly intended questions of arbitrability to be decided by the arbitrator.[31] The Seventh Circuit, citing its holding in *Edward D. Jones & Co. v. Sorrells*,[32] held that the sections of the NASD Code were not the kind of clear and unmistakable language that the Supreme Court requires.[33] Thus, the court held, "the issue of arbitrability here was properly one for the court to resolve."[34]

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[29] *Id.*

[30] CODE OF ARBITRATION PROCEDURE (National Ass'n of Sec. Dealers 1997). The three sections include, first, Part I, Section 1 governing "Matters Eligible for Submission" to arbitration, which reads in pertinent part:

> This code of Arbitration Procedure is prescribed and adopted pursuant to Article VII, Section 1(a)(3) of the By-Laws of the Association for the arbitration of any dispute, claim, or controversy arising out of or in connection with the business of any member of the Association . . . :(c) between or among members or associated persons and public customers, or others.

Id. at ¶ 7511. Second, Part III, Section 12(a) for "Required Submission" which reads:

> Any dispute, claim, or controversy eligible for submission under the Rule 10100 Series between a customer and a member and/or associated person arising in connection with the business of such member or in connection with the activities of such associated persons shall be arbitrated under this Code, as provided by any duly executed and enforceable written agreement or upon demand of the customer.

Id. at ¶ 7571. Third, Part III, Section 35 on "Interpretations of Provisions of Code and Enforcement of Arbitrator Rulings," which describes the scope of the arbitrators' authority: "The arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code and to take appropriate action to obtain compliance with any ruling by the arbitrator(s). Such interpretations and actions shall be final and binding upon the parties." *Id.* at ¶ 7581.

[31] *See Miller*, 139 F.3d at 1133.

[32] 957 F.2d 509 (7th Cir. 1992). In this case, the Seventh Circuit held that section 35 of the NASD Code of Arbitration Procedures is not a clear and unmistakable expression of the parties' intent to have the arbitrators, and not the court, determine whether section 15 of the NASD Code imposes an absolute bar to arbitration for claims more than six years old.

[33] *See Miller*, 139 F.3d at 1134.

[34] *Id.*

After determining that the district court properly decided the competent forum issue, the Seventh Circuit reviewed the district court's grant of a preliminary injunction against the Flumes' second arbitral proceeding.[35] After interpreting the applicable NASD Code sections, the Seventh Circuit held that the district court erred by giving the arbitration provisions too narrow a reading and that the Flumes' claims were in fact arbitrable under the NASD Code.[36] Thus, the Seventh Circuit vacated the preliminary injunction and ordered the brokers to submit to the second arbitration with the Flumes.[37]

IV. ANALYSIS OF THE SEVENTH CIRCUIT'S OPINION

In *AT&T Technologies, Inc. v. Communications Workers*,[38] the Supreme Court held that "the question of arbitrability . . . is undeniably for judicial determination. Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator."[39] Furthermore, in *Kaplan* the Supreme Court made clear that "[j]ust as the arbitrability of the merits of a dispute depends upon whether the parties agreed to arbitrate that dispute, . . . so the question 'who has the primary power to decide arbitrability' turns upon what the parties agreed about that matter."[40] However, questions of who should decide arbitrability are treated differently than questions of whether a particular dispute is arbitrable under a valid arbitration agreement: in the latter cases, courts resolve all doubts in favor of arbitration, while in the former cases, the presumption is reversed.[41] Thus, a court's analysis for determining the proper forum for

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[35] *See id.* The Seventh Circuit applied an abuse of discretion standard of review. *See id.*

[36] *See id.* at 1137. Specifically, the Seventh Circuit held that the Flumes remained "customers" within the meaning of the NASD Code and that the Flumes' dispute arose "out of" or "in connection with" a dispute between or among an NASD member and a public customer. *See id.* at 1136.

[37] *See id.* at 1137.

[38] 475 U.S. 643 (1986).

[39] *Id.* at 649.

[40] First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 943 (1995).

[41] *See Kaplan*, 514 U.S. at 943–945 (citing Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 626 (1985); United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574, 582–583 (1960)).

arbitration issues necessarily begins with a review of the parties' agreement and intentions.[42]

In *Kaplan*, the Supreme Court justified its decision to create a presumption that the parties intended for a court to decide arbitrability questions by focusing on the probable precontractual considerations of the parties.[43] The Supreme Court explained that when the arbitration agreement is ambiguous or silent on the point of "who should decide arbitrability questions," giving the power to arbitrators "might too often force unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator, would decide."[44] Thus, the Supreme Court reasoned, because a party can be forced to arbitrate only those issues it specifically has agreed to submit to arbitration, courts are hesitant to presume a party intended arbitrators to decide arbitrability questions absent clear and unmistakable evidence of such an intention.[45]

Despite the Supreme Court's adoption of the clear and unmistakable standard, lower courts have continued to reach conflicting results with respect to whether a dispute is arbitrable under particular contractual agreements.[46] Section 35 of the NASD Manual's Code of Arbitration Procedures, a provision at issue in *Miller*, is an example of contractual language with which the circuits have struggled.[47] Because the Supreme Court has yet to resolve this issue, parties to an arbitrability dispute are treated differently depending on the circuit in which their case is brought.[48]

Several circuits, including the Sixth, Tenth, and Eleventh, have interpreted section 35 in a manner consistent with the Seventh Circuit's

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[42] *See Miller*, 139 F.3d at 1133.

[43] *See* Kevin Michael Flowers, Recent Development, 12 OHIO ST. J. ON DISP. RESOL. 801, 805 (1997).

[44] *Kaplan*, 514 U.S. at 945. The Court noted that the question of "whether a particular merits-related dispute is arbitrable" warrants a presumption in favor of arbitration because, in that case, the parties have a contract that provides for arbitration of some issues. Thus, the Court reasoned, the parties likely gave at least some thought to the scope of arbitration. However, the Court noted, the question of "who should decide arbitrability" is rather arcane. Therefore, a party might not focus upon that question or upon the significance of having arbitrators decide the scope of their own powers. *See id.* at 944–945.

[45] *See id.*

[46] *See, e.g.*, PaineWebber, Inc. v. Bybyk, 81 F.3d 1193, 1202 (2d Cir. 1996) (holding that the language of section 35 of the NASD Code indicates that parties clearly and unmistakably wanted questions of arbitrability to be decided by the arbitrator).

[47] *See Miller*, 139 F.3d at 1134.

[48] *See id.*

approach in *Miller*.[49] In *Smith Barney, Inc. v. Sarver*,[50] the Sixth Circuit held that section 35 of the NASD Code of Arbitration Procedure did not provide clear and unmistakable evidence of the parties' intention to have arbitrators determine the timeliness of their arbitration claim.[51] In its opinion, the Sixth Circuit concurred in the Eleventh Circuit's holding in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cohen*,[52] and posited that, at most, section 35 creates an ambiguity as to who determines arbitrability under the NASD Code.[53] Thus, applying the Supreme Court's *Kaplan* standard, both the Sixth and Eleventh Circuits held that, because an ambiguity is insufficient to rebut the presumption that courts determine arbitrability, courts, not arbitrators, should properly decide questions of arbitrability for NASD disputes.[54]

Similarly, in *Cogswell v. Merrill Lynch, Pierce, Fenner & Smith Inc.*,[55] the Tenth Circuit held that section 35 says nothing specific about whether the arbitrator or the court should decide whether a claim is arbitrable and, thus, that this issue should be left to the court.[56] While other circuits have rejected this analysis of section 35, the majority of circuits that have addressed the question have agreed that section 35 does not provide clear and unmistakable evidence of the parties' intent to have arbitrators decide questions of arbitrability.[57]

A minority of circuits that have addressed the question of the proper forum for arbitrability disputes under the NASD Code have held that the language of section 35 indicates that the parties clearly and unmistakably wanted questions of arbitrability to be decided by the arbitrator.[58] In

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[49] *See* Smith Barney, Inc. v. Sarver, 108 F.3d 92 (6th Cir. 1997); Cogswell v. Merrill Lynch, Pierce, Fenner & Smith Inc., 78 F.3d 474 (10th Cir. 1996); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cohen, 62 F.3d 381 (11th Cir. 1995).

[50] 108 F.3d 92 (6th Cir. 1997).

[51] *See id.* at 97.

[52] 62 F.3d 381 (11th Cir. 1995).

[53] *See Smith Barney*, 108 F.3d at 97 (citing *Merrill Lynch*, 62 F.3d at 384).

[54] *See id.* at 97 (citing *Merrill Lynch*, 62 F.3d at 384).

[55] 78 F.3d 474 (10th Cir. 1996).

[56] *See id.* at 480–481.

[57] *See Smith Barney*, 108 F.3d at 96 (noting that the Sixth Circuit explicitly rejects the view expressed by a minority of circuits that section 35 provides clear and unambiguous language evidencing the parties' intent to submit questions of arbitrability to the arbitrator).

[58] *See, e.g.*, PaineWebber, Inc. v. Bybyk, 81 F.3d 1193, 1202 (2d Cir. 1996); FSC Sec. Corp. v. Freel, 14 F.3d 1310, 1312–1313 (8th Cir. 1994).

PaineWebber, Inc. v. Bybyk,[59] the Second Circuit posited that section 35 clearly indicates that issues of arbitrability should be decided by an arbitrator.[60] Similarly, in *FSC Securities Corp. v. Freel*,[61] the Eighth Circuit held that the parties' adoption of section 35 was a clear and unmistakable expression of their intent to leave questions of arbitrability to the arbitrators.[62] The Fifth Circuit has concurred in this reasoning in *Smith Barney Shearson, Inc. v. Boone*.[63]

The circuits that have adopted the position that section 35 commits resolution of questions of arbitrability to the arbitrators have focused on the language of the provision as a justification for their holdings.[64] In *FSC Securities*, the Eighth Circuit stated that "[i]n no uncertain terms, section 35 commits interpretation of all provisions of the NASD Code to the arbitrators."[65] Moreover, in *PaineWebber*, the Second Circuit posited that "[t]he language of the Code itself commits all issues, including issues of arbitrability . . . to the arbitrators."[66] Thus, the minority of circuits that have held in favor of arbitration have concluded that section 35 provides the kind of clear and unmistakable evidence that the Supreme Court has said is necessary to rebut the presumption that courts, not arbitrators, should decide questions of arbitrability.[67]

In *Miller*, the Seventh Circuit reaffirmed its position among the majority of circuits and rejected the view that section 35 provides for an

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[59] 81 F.3d 1193 (2d Cir. 1996). The Second Circuit held that the NASD Code had not been incorporated in this case, so section 35 was irrelevant to a determination of the parties' intentions concerning arbitrability. However, the court stated that, if the NASD Code had been incorporated, the court would have held that section 35 is a clear and unmistakable expression of the parties' intent to have arbitrators decide questions of arbitrability. *See id.* at 1202.

[60] *See id.*

[61] 14 F.3d 1310 (8th Cir. 1994).

[62] *See id.* at 1312–1313. Specifically, the Eighth Circuit held that section 35 commits interpretation of section 15 of the NASD Code, which deals with timeliness of claims, to the arbitrators. *See id.*

[63] 47 F.3d 750 (5th Cir. 1995).

[64] *See, e.g.*, *FSC Sec.*, 14 F.3d at 1312–1313.

[65] *Id.* at 1313.

[66] PaineWebber, Inc. v. Bybyk, 81 F.3d 1193, 1202 (2d Cir. 1996). The Second Circuit concurred in the Eighth Circuit's analysis in *FSC Sec.* and stated that the parties agreed to give the arbitrators discretion via section 35. *See id.* (quoting *FSC Sec.*, 14 F.3d at 1313).

[67] *See FSC Sec.*, 14 F.3d at 1312–1313 (noting that the Eighth Circuit expressly rejects the Seventh Circuit's approach to section 35).

arbitral determination of arbitrability questions. Citing the Supreme Court's mandate in *Kaplan*, the *Miller* court was not convinced that the language of section 35, empowering the arbitrator to interpret and determine the applicability of all provisions under the Code, satisfied the clear and unmistakable standard.[68]

V. IMPACT OF *MILLER* ON ALTERNATIVE DISPUTE RESOLUTION

The Seventh Circuit's holding in *Miller* accentuates the debate and disagreement among the circuits over whether section 35 of the NASD Code provides the sort of clear and unmistakable evidence required by the Supreme Court. Since the Supreme Court laid down the clear and unmistakable standard in *Kaplan*, a debate over what contractual language suffices has endured.[69] The effect is that parties' arbitrability disputes arising under the NASD Code will be resolved differently depending on the jurisdiction in which their claim is brought. While a majority of the circuits will hold that a court decides what claims are arbitrable, a distinct minority of courts will decide that the arbitrator should properly resolve arbitrability disputes arising under the NASD Code. If a party entering into an arbitration agreement that incorporates the NASD Code desires questions of arbitrability to be resolved by the court, the party should take further steps to include express language stating this intention. Otherwise, until the Supreme Court resolves this question, interpretation of section 35 will continue to vary depending on the circuit in which the arbitrability dispute originates.

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[68] *See* Miller v. Flume, 139 F.3d 1130, 1134 (7th Cir. 1998).

[69] *See* Neesemann & Nelson, *supra* note 1, at 402 (noting that the Supreme Court's standard has failed to end all confusion among the circuits).